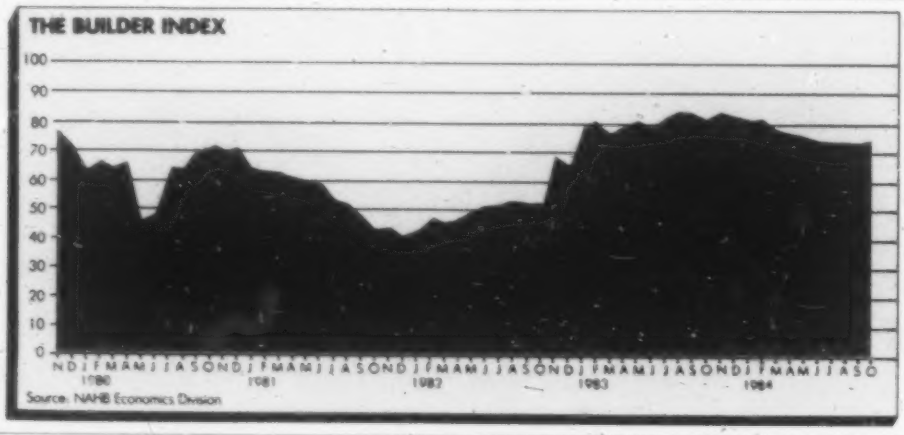
OUTLOOK

A HOUSING INDUSTRY ANALYSIS
PREPARED BY THE
NAHB ECONOMICS DIVISION



For the first time in six months the BUILDER Index increased. And it increased sharply to 74.24, indicating a big improvement in the six-month outlook for starts.

The BUILDER Index measures near-term (3 to 6-month) housing activity. It is a composite of seven housing industry indicators: building permits, Government National Mortgage Association yields, the Producer Price Index (construction materials), framing lumber and plywood composite prices, builders' sales expectations, home buyer traffic and the confidence index of home buying. The BUILDER Index is updated monthly.

Tapering Off

Michael Sumichrast
NAHB Chief Economist, Washington, D.C.

When it comes to housing starts, this year started with a bang. But it looks now as if it will end much more quietly. During the first quarter—January to March—the rate of starts averaged almost 2 million units. In the second quarter it averaged 1.9 million units. But in the third quarter starts fell to an average annual rate of 1.62 million, a 15 percent drop.

Even with that drop starts for the first nine months still are 5 percent above the same period in 1983. But a cumulative month-to-month comparison shows a continual decline in the rate of increase, which is another way of saying the housing boom has quieted considerably.

Last year housing starts—private and public—hit 1,712,500 units, a 60 percent increase over the 1 million starts in 1982. Assuming our forecast of declining activity holds true, 1984 will end up with about 1.72 million starts, not a bad year at all.

What these overall numbers do not and obviously could not show is the relative unevenness of the improvement from last year. In other words, some states are big winners, while others are big losers.

The greatest surprise may be that 92 percent of the total increase occurred in only three states: California, Arizona and Florida. More specifically, a comparison of housing starts during the first eight months of this year and last shows 85,900 additional starts this year. Of those 48,455 (or 56 percent) were in California, 15,249 (or 18 percent) were in Arizona and 15,023 (or 18 percent) were in Florida.

CUMULATIVE MONTHLY DIFFERENCE IN STARTS: 1983–84

	Units	Percent
First month	17,800	20%
2 months	51,500	28
3 months	105,900	17
4 months	97,200	20
5 months	97,000	15
6 months	107,800	13
7 months	108,300	11
8 months	77,800	7
9 months	70,600	5
10 months*	55,800	4
11 months*	31,500	2
12 months*	15,700	1

e- Estimate by NAHB Economics Division

As for the big losers, most of these are states where weak oil prices have hurt the economy. They include Texas, Oklahoma and Alaska. Other losers were Colorado, Nevada, Maryland, Montana, Louisiana, North Dakota and Wyoming.

Starts in Texas, for example, were down 44,224 units during the first eight months of this year; Oklahoma was down 10,327 units; Alaska 4,494 units; Colorado 2,841; and starts in Nevada were down 2,665 units.

In the states where housing improved so did employment. In California the 48,455-unit increase in starts was matched by an increase of 432,500 jobs. And in Florida, where starts jumped 15,249 units, there were 231,600 new jobs.

In addition to California, Arizona and Florida, South Carolina and New York make up the top five states in housing starts increases. South Carolina added about 70,000 new jobs, and New York 200,000.

Employment in Texas also increased—167,500 new jobs from a year ago—but the oil glut and overbuilding

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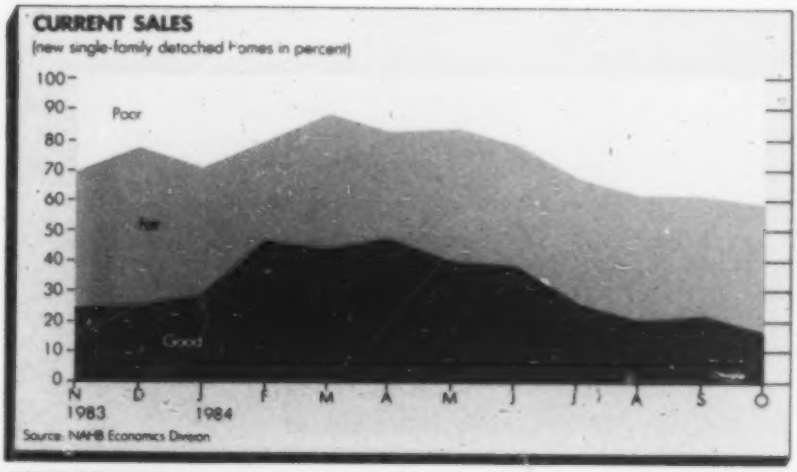

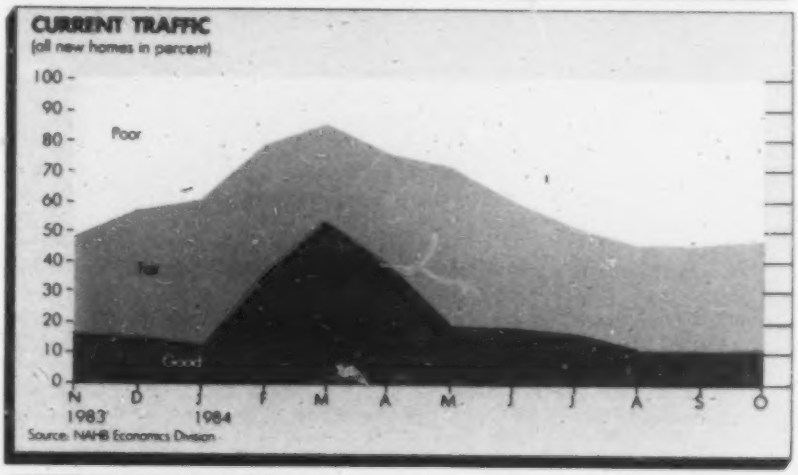

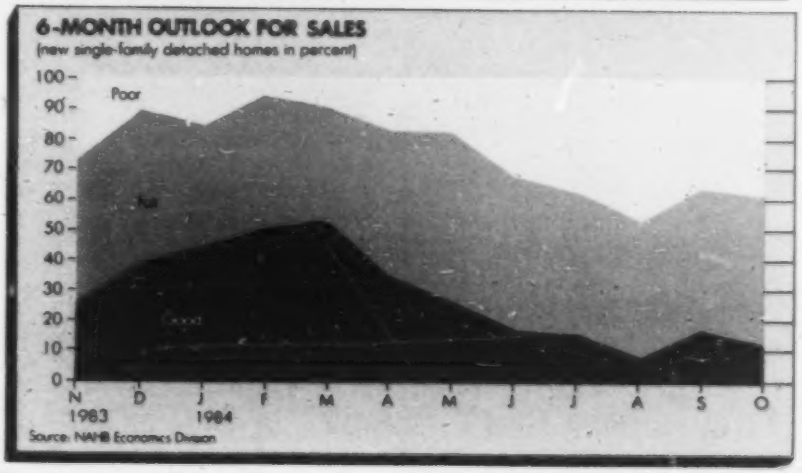

PESSIMISM REIGNS

The slowdown in new home sales and the deterioration of builders' expectations that began in April and continued through the summer resumed again in October after last month's brief respite.

According to the most recent BUILDER poll both current sales and sales expectations for the next six months declined in October. And in spite of fairly steady recent declines in mortgage interest rates, the builders surveyed for the most part blamed high interest rates for sluggish sales and their own pessimism.

A Texas builder said, "Buyers are pensive. High rates make them worry, and ARMs scare them." And an Idaho builder said, "The problem is financing. The demand is there, but buyers just can't qualify."

While traffic actually is marginally higher (middle chart), current sales dropped to the lowest level in 19 months. Only 17 percent of those surveyed said sales were good, and 41 percent said sales were poor (top chart).

At the same time builders' expectations (bottom chart) declined to the lowest level in two years. Only 12 percent expect sales to be good for the next six months, down from a peak of 53 percent in March.

The information on this page is based on a survey of approximately 800 builders. The survey, conducted each month for BUILDER by the NAHB Economics Division, asks builders to rate present new home sales, current traffic and the 6-month sales outlook as either good, fair or poor.

DELINQUENCIES DOWN
Mortgage delinquencies declined slightly from 5.48% in the first quarter of this year to 5.46% in the second quarter, according to the Mortgage Bankers Association. However, the proportion of home mortgages entering foreclosure rose during the same period to 0.21% from 0.19%. Delinquency rates (mortgage payments 30 days or more past due) for the second quarter were 3.66% for conventional loans, 6.99% for FHA loans and 6.12% for VA mortgages.

SOUTHERN ACCENT
New home sales jumped in September primarily due to a burst of activity in the South, where the combination of high demand and lower interest rates pushed up single-family sales by 52% to an annual rate of 386,000, the Census Bureau reports. September sales increased 3% in the West, but declined 14% in the Midwest and 5% in the Northeast. The inventory of new single-family homes at the end of September stood at a 6.5-month supply at the September sales pace.

REPEAT PERFORMANCE
It was a different story for sales of existing single-family homes. They declined 1% to an annual rate of 2.67 million, reports the National Association of Realtors. It was the fifth straight month that resales dipped, however the rate of decline has slowed since July. September resales dropped most in the West (11.5%) and dropped 4% in the Northeast; resales rose 6% in the South and 1.4% in the Midwest. At the end of September, 2.5 million existing homes were for sale. That's an 11.3-month supply at the September sales rate. Resale prices also dipped in September by $1,100, or 1.5%, to a median price of $72,600. But that price was nearly 4% higher than a year earlier.

ENERGY EXTRA
Good news for builders of energy-efficient homes. The Federal National Mortgage Association (Fannie Mae) has clarified its guidelines for buying loans on energy-efficient houses, and it looks as if Congress will extend the energy tax credit due to expire at the end of 1985, though possibly with some changes. Fannie Mae's revised guidelines allow lenders to increase by 2 percentage points the proportion of a home buyer's income that can go to housing expenses if the home is energy efficient. (The current typical limit is 28%.) That helps more buyers qualify for mortgages. Homes qualify as energy efficient if they are built according to NAHB's energy guidelines or are judged energy efficient by an appraiser. As for the energy tax credit, the Senate may try to curb some benefits in the name of deficit reduction but the credit probably will be extended past 1985, according to a Senate Finance Committee spokesperson.

TYING A RECORD
The value of all construction contracts in 1985 will equal this year's expected record of $211 billion, predicts George Christie, chief economist of McGraw-Hill Information Systems. "As interest rates retreat during 1985, the next several quarters are likely to be a replay of 1984—but in reverse, with housing picking up strength in the second half of the year," he said. (Other economists predict a different pattern for interest rates. See the economic forecast story on page 36.) Christie also expects industrial construction to grow by 16% next year while office construction declines 17%.

CONDO CRAZE
Multifamily housing is on the way up. Its share of total housing starts will rise from 35% in 1983 to around 43% in 1995, predicts Chemical Bank economist Herve Kevenides. But most of that increase will be in condos and co-ops, not rental housing. During the next decade, single-family starts will average 1 million a year, rental starts 400,000 and condo and co-op units 365,000, Kevenides says. At the same time, mobile homes will average about 300,000 new units a year. The level of rental construction will average only 400,000 units a year—30% less than was built during the 1970s—largely because the number of people under age 35 will decline sharply.

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brought housing starts down.

In terms of percentage of employment growth, these were the top 10 states: Arizona, up 6.3 percent; Tennessee, up 6.2 percent; Florida, up 6 percent; Minnesota, 6 percent; Georgia, 5.9 percent; Utah, 5.7 percent; South Carolina, 5.3 percent; California, 4.4 percent; New Mexico, 4.2 percent; and Arkansas, 4 percent.

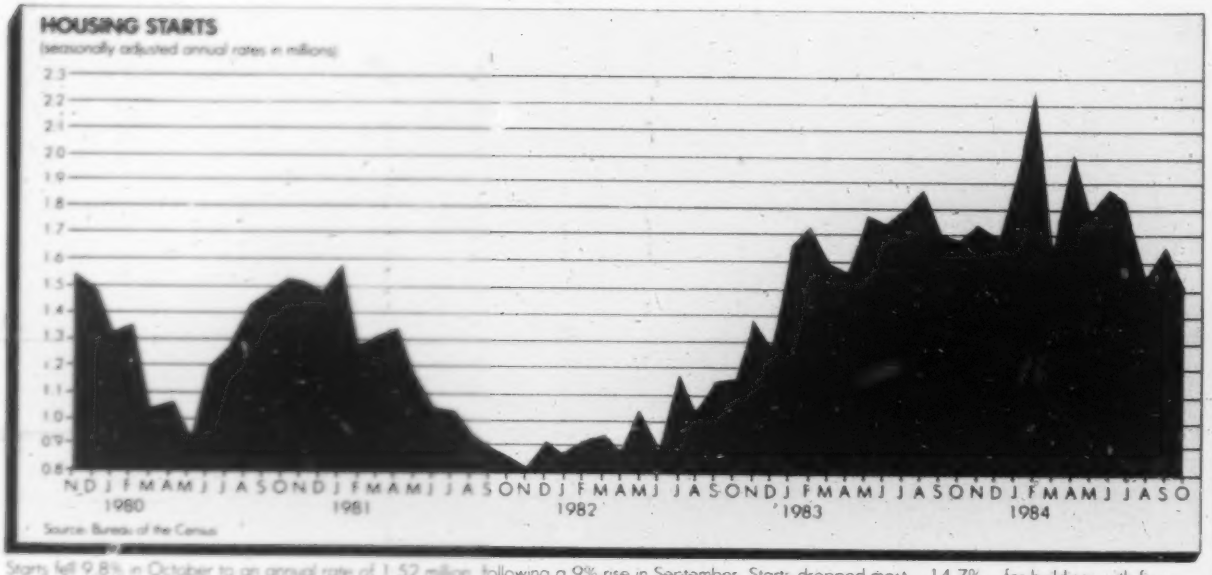
The bottom 10, those with the smallest percentage increase in employment, were Montana, up 1.3 percent; Iowa, up 1.3 percent; Oklahoma, 1.1 percent; West Virginia, 1 percent; Mississippi, 0.8 percent; Delaware, 0.6 percent; District of Columbia, 0.6 percent; Hawaii, 0.5 percent; and North Dakota, 0.1 percent.

Of course the employment picture isn't the only one to look at in assessing housing. Interest rates remain the key, and we expect rates to continue to soften through the year, mainly because of moderation in the rate of economic growth and the low level of inflation. As a matter of fact, disinflation is a possibility, given the softness of worldwide commodity prices.

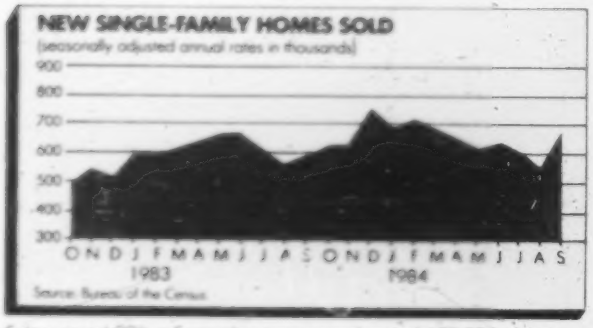
By the end of the year the federal funds rate could be down to 9 to 10 percent, the prime could decline to 11.5 to 12 percent and the long-term government rate could drop below 12 percent.

A year from now, however, the prime could be back to 14 percent or a little higher. For that reason expect that 1985 will be a year marked by a gradual decline in sales and starts. How much? A drop in starts of 15 to 20 percent seems like a reasonable estimate at this time.

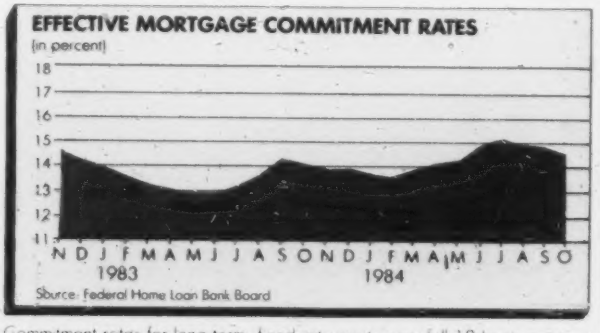
OUTLOOK/STATISTICS



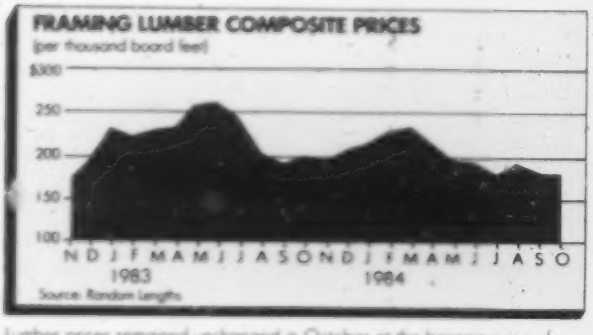
Starts fell 9.8% in October to an annual rate of 1.52 million, following a 9% rise in September. Starts dropped most—14.7%—for buildings with five or more units. October starts were down 9.4% from a year earlier.



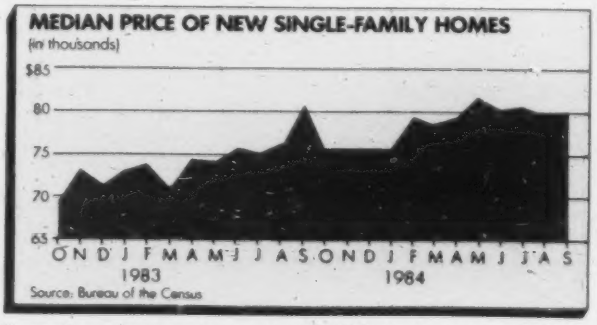
Sales jumped 22% in September to an annual rate of 679,000 after the August rate was revised downward. Almost all of the increase was in the South. The September rate was nearly 14% higher than a year earlier.



Commitment rates for long-term, fixed-rate mortgages fell 18 basis points in October to 14.72%. A year earlier the rate was 14.08%. But uncapped adjustable rates rose 4 basis points to 13.20%.



Lumber prices remained unchanged in October at the bargain price of $180 per thousand board feet. That was 10% lower than the price a year earlier.


MEDIAN PRICE OF NEW SINGLE-FAMILY HOMES
(in thousands)
$85
80
75
70
65
O N D J F M A M J J A S O N D J F M A M J J A S
1983
1984
Source: Bureau of the Census

The median price of new houses rose to $80,000 in September, up $300 from the downwardly revised August price. The September price was 1% lower than a year earlier.

NEWS

FINANCE

DESPITE RECOVERY S&Ls ARE IN TROUBLE

Although 1984 has been a recovery year for the thrift industry, it still isn't home free.

Thrifts received a jolting reminder of this recently when the biggest among them, American Savings of California, nearly bit the dust.

The giant S&L, still on rocky ground, suffered a run on deposits after reporting a big second quarter loss. Its doors reportedly were propped open by a $2 billion loan from the Federal Home Loan Bank of San Francisco.

But American Savings isn't the only thrift still in trouble.

Although the proportion of FSLIC-insured savings institutions operating in the red has plunged from a phenomenal high of 85 percent in late 1981, nearly a quarter of the industry still isn't making a profit. And those are the survivors.

A total of 142 FSLIC-insured institutions failed from 1980 through this October. Failures dropped from a high of 48 in 1982, the bottom of the recession, to 20 in the first 10 months of this year. By comparison only three savings institutions failed in 1979.

Most failures have been FSLIC-assisted mergers rather than outright closings, but many more troubled institutions have been merged without assistance. The total number of FSLIC-insured institutions fell 24 percent from 4,000 in 1980 to about 3,000 last year.

While most institutions were zapped by high interest that kept loan demand down and rates on deposits up, American Savings, a subsidiary of Financial Corp. of America, hit the skids, analysts say, because it grew too fast, going after allegedly risky loan business that scared federal regulators.

Regulators still are scared but not just about American Savings. The savings industry seems to have two large and quite different problems.

On one hand, most institutions still are saddled with a large number of below-market fixed-rate mortgages. The second, more recent problem is exceptional—excessive, in the eyes of regulators—growth by many big institutions such as American Savings.

During the last two years, thrifts have made substantial progress toward mitigating the first problem by aggressively and successfully marketing adjustable rate mortgages (ARMs). ARMs accounted for 64 percent of all mortgage originations in October. Still, 60 percent of the portfolio loans of thrifts were fixed-rate at the end of the first half of the year, and roughly half of those fixed-rate loans carry a below-market interest rate.

The continuing mismatch between rates and maturities of assets (loans) and liabilities (deposits) has led to a squeezed—though improved—spread between thrifts' cost of funds and their mortgage yields.

According to the Federal Home Loan Bank Board, which regulates federally chartered savings institutions, the spread was 1.85 percent for the second quarter of this year. That's up from 1.63 percent in the first quarter and far better than the negative spreads of 1981-82, but thrifts say they need a 2 percent spread to be comfortable.

Profits, too, are up. But, again, thrifts say they aren't making enough. Net income after taxes grew from a 0.16 percent annualized rate of return on assets in the first quarter of 1984 to 0.31 percent in the second quarter.

The combined rate of return for the first half of 1984 was slightly higher than that of the second half of 1983 but lower than the overall rate for last year. Back in 1981 and 1982 the industry lost money.

In short, the thrift industry has revived but needs more time to recover fully. Lower, stable interest rates are the main thing that can provide that time.

"We still need time to restructure . . . to work off our immense portfolios of old, fixed-rate loans," said Paul Prior, 1984 chairman of the U.S. League of Savings Institutions, in a speech to the league's annual convention in late October.

"One year ago we were looking forward to a 1984 that would see us make great strides on the road back to profitability. But things didn't turn out that way" because of rising interest rates. Prior called recent rate declines "heartening" but possibly "short-lived." The only way to bring interest rates down for good, he said, is to cut the federal budget deficit.

The savings industry is in its best shape in nearly five years, according to Eric Hemel, chief economist of the Federal Home Loan Bank Board, who credited the industry with doing "an incredible job" of reducing its interest rate risk through the use of ARMs.

But Hemel said the industry faces a new danger from excessive growth. Total thrift industry assets grew at an annual rate of 21 percent during the first half of 1984 compared with an 8 percent growth rate for commercial banks. Thrift assets totaled $938 billion in September—a 35 percent jump since 1982—and Hemel expects assets to hit $1 trillion early next year.

So, what's wrong with growth? The problem for thrifts is that earnings are lagging far behind growth, and some of the new lending strategies are considered risky, especially by the Bank Board.

All this is "very scary" to the Bank Board, Hemel said, because the regulators haven't been able to keep up with those being regulated, and it is worried that thrift failures could increase and strain the FSLIC insurance fund.

MORTGAGE YIELD AND COST OF FUNDS FOR FSLIC-INSURED SAVINGS INSTITUTIONS

Year	Mortgage yield	Cost of funds	Spread
1984 (Jan.-June)	11.51%	9.77%	1.74%
1983	11.17	9.83	1.34
1982	10.68	11.38	−0.70
1981	9.91	10.92	−1.01
1980	9.34	8.94	0.40
1979	8.86	7.47	1.39

Source: Federal Home Loan Bank Board

(The $6 billion in the FSLIC fund isn't much to insure a $1 trillion industry, but the fund did survive the 1981-82 recession when much of the industry was close to collapse.)

Why are many thrifts growing so fast? One big reason is the new powers Congress gave federally chartered thrifts in the 1982 Depository Institutions Act to keep them alive.

The legislation allowed thrifts to compete with money market funds, which had raided their deposits, by offering a new market rate account. That account attracted huge, though expensive and volatile, deposits that thrifts (and banks) had to invest somewhere.

Fortunately—at least for thrifts—the legislation also gave them more places to put their deposits. For the first time they could make commercial loans and tangible personal property loans, such as for mobile homes. Thrifts also could make more nonresidential real estate loans and more consumer loans.

Home builders were worried that those new lending powers would greatly reduce thrifts' support for housing. But many institutions have been slow to use the powers. They've been too busy switching to ARMs.

Now that ARMs are well planted, thrifts are expected to make more use of their expanded lending powers to diversify their loan portfolios and shield themselves from the ups and downs of the housing market. The big ones already have, and that's a primary reason for the industry's rapid growth.

"Congress gave us new powers to help us diversify, and we've started to use them," Prior said. But he added that ARMs, "if the politicians leave them alone, will allow us to remain primarily housing lenders."

Prior acknowledged that "deregulation has brought more risk-taking," but he maintained that only a small number of institutions are going out on a limb.

However, Hemel noted that "just a few risk-taking S&Ls can force conservative institutions to take more risks in order to compete. That's the deregulation world we live in."

Bank Board chairman Edwin Gray told the league convention that savings institutions need diversification options, but that housing must remain their primary lending function.

"Efforts which have the effect of subordinating the mortgage lending function of savings institutions to other activities all are in direct conflict with the legal and philosophical underpinnings of the Federal Home Loan Bank System," Gray said bluntly.

James Christian, chief economist for the league, said excessive growth is a problem for some institutions and that "one overly aggressive lender can mess up a whole market." But he doesn't think the situation is as serious as Gray indicated.

Part of the problem, according to Christian, is that the regulators haven't changed as fast as the thrift industry has, "so it's hard for the regulators to judge the soundness of the new loans."

Nevertheless, both Gray and Treasury Secretary Donald Regan favor charging higher FSLIC insurance premiums to thrifts engaged in risky lending. And Gray believes that state-chartered and state-regulated thrifts, now insured by the FSLIC, should be insured by state insurance funds.

Carol Anderson, news editor

NET INCOME AFTER TAXES FOR FSLIC-INSURED SAVINGS INSTITUTIONS

Year	Return on assets
1984 (Jan.-June)[1]	0.24%
1983	0.27
1982	−0.64
1981	−0.73
1980	0.13
1979	0.67

[1] Annualized rate of return
Source: Federal Home Loan Bank Board

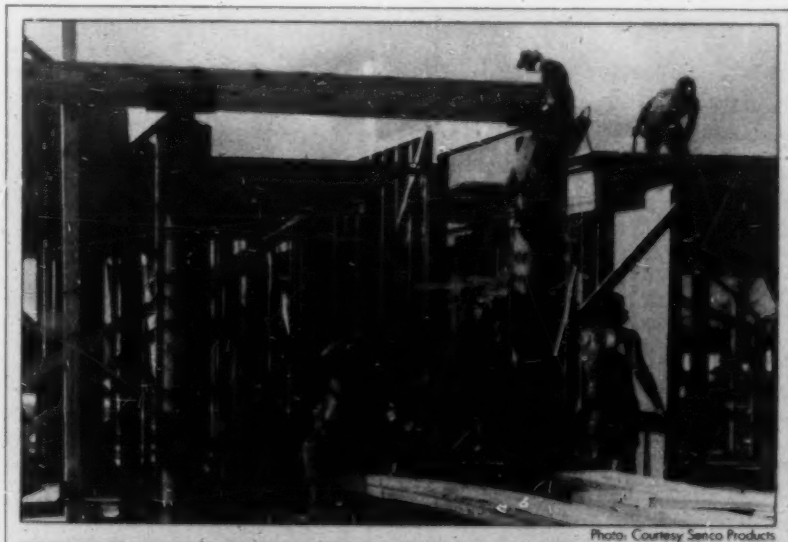


Photo: Courtesy Senco Products

DESIGN

NEW AMERICAN HOME TO BE UNVEILED IN HOUSTON

There's a smorgasbord of design ideas at the second annual New American Home to be unveiled at the 41st Annual Convention and Exposition of the National Association of Home Builders in Houston. Designed by Fisher Friedman Associates, the home is targeted to the move-up market. The 2,200-square-foot house mixes modern amenities and materials with the best ideas from the past, including energy-efficient overhangs and screened porches. A joint venture of BUILDER, *Good Housekeeping* and the National Council of the Housing Industry, the house was built by Gemcraft, a Houston home builder. The New American Home '85 will be open daily during the convention January 26 to 29, 1985. It is located at the Lakes of Fondren Southwest, a custom home community 15 minutes from the Astrodomain complex.

ECONOMY

ECONOMISTS FORECAST A GOOD YEAR AHEAD

Next year should be a pretty good year for housing even though production is expected to decline and interest rates to increase.

At NAHB's semiannual Residential Construction Forecast Conference held in late October, NAHB predicted starts would fall 13.6 percent in 1985 to 1.5 million, down from an estimated 1.74 million starts this year.

"That's a reasonably good year considering we expect higher interest rates," said Michael Sumichrast, NAHB senior staff vice president and chief economist. "We'll muddle through in 1985. Builders will have difficulty selling what they build, but there won't be a recession."

Other forecasters at the conference agreed. Leonard Santow, a partner in the New York City investment consulting firm Griggs & Santow, Inc., and Lawrence Chimerine, chairman and chief economist of Chase Econometric Associates, an economic forecasting firm based near Philadelphia, predicted starts in the range of 1.5 million to 1.6 million next year.

But all of them expect 1986 to be worse. "We probably won't get through 1986 without a recession" unless substantial progress is made on reducing the federal budget deficit, said Santow, who predicted 1.1 million to 1.4 million starts in 1986. But none of the forecasters expected much progress on the deficit.

Back to 1985, NAHB predicted that multifamily starts will fall the most—16.6 percent to 584,000 units, while single-family starts are expected to decline 11.5 percent to 923,000. Almost all of the multifamily drop will be in buildings with five or more units.

Regionally, NAHB predicts that the North Central and West will be hit hardest next year. Starts in the North Central are expected to plunge 24 percent, followed by drops of 22 percent in the West and 10 percent in the South. Only the Northeast is expected to experience a modest (3.2 percent) increase in starts.

As for interest rates, most of the forecasters were reluctant to predict specific numbers, but all saw rates rising early next year. Santow predicted that rates on fixed-rate mortgages would fall to a low of 12.5 percent late this year, stay there for the first few months of 1985, then start rising.

According to NAHB's forecast, the prime rate will fall to a low of 12 percent late this year, then climb more than 2 percentage points from 12.5 percent in the first quarter of 1985 to 14.8 percent in the fourth quarter of next year.

HOUSING STARTS
(in thousands)

Markets	1984 estimate	1985 forecast	Percent change
U.S. total	1,743	1,507	−13.6
Single-family	1,043	923	−11.5
Multifamily	700	584	−16.6
Northeast	191	197	3.2
Single-family	137	129	− 6.3
Multifamily	54	68	27.6
North Central	244	185	−24.2
Single-family	166	126	−24.1
Multifamily	78	59	−24.6
South	879	791	−10.0
Single-family	513	466	− 9.1
Multifamily	366	325	−11.4
West	430	334	−22.2
Single-family	228	202	−11.1
Multifamily	202	132	−34.7
Mobile homes	334	313	− 6.4

Source: NAHB Forecasting Service

Housing activity started to slow down this year and will continue to decline next year because much of the pent-up demand, especially by first-time buyers, was satisfied, Chimerine explained. In addition, he said the existing home market has not rebounded because high mortgate rates have discouraged owners from trading up—and that limits the new home market. What's more, high rates have started to affect multifamily starts.

"The slowdown this summer was more severe than expected," Chimerine said, "but it wasn't the start of a new recession."

Santow blamed rate rises earlier this year on the financial markets, which he said overreacted to actions taken or expected to be taken by the Federal Reserve Board. In fact, Santow said, the Fed made few major changes in monetary policy.

By the same token, Santow attributed the modest decline in interest rates since late summer to the markets correcting previous overreactions. He stressed that the declines are temporary, not the beginning of a downward trend. Nevertheless, the rate declines "bought housing another year."

Most of the news at the conference was mixed. And that was the story with inflation too. All the forecasters predicted that the inflation rate would accelerate from the current 3 to 4 percent rate up to 5 to 6 percent by next fall. But nobody expected an inflation explosion.

Much of the conference discussion centered on the federal deficit and its looming impact on the economy and interest rates. Although the deficit declined about 10 percent in fiscal 1984 to about $175 billion, Santow expects it to remain about the same next year, then shoot up to around $250 billion "in the next recession."

That 10 percent decline in the deficit this year "was relatively small given the strength of the recovery in 1983 and the first half of 1984," Chimerine said. "Growth in tax receipts is lagging behind economic growth—contrary to the theory of supply-side economics."

Both Chimerine and Santow believe taxes must rise in order to dent the deficit. "Believing that we can solve the deficit problem only by reducing spending is a pipe dream," Santow declared. Both predicted that next year Congress will move to slap a minimum tax on corporations which now "pay very little in taxes."

Carol Anderson

CONTINUED FROM PAGE 40

rado Springs, for $60 a square foot, the home is dominated by sunspaces—one on each level—which constitute 35 percent of the floor space. The sunspaces contain the airlock entry, stairway, halls, dining and sitting areas on the upper level, and whirlpool tub and recreation room on the lower level. All interior spaces open onto a sunspace.

Air heated in the sunspace warms interior spaces by natural convection and rises to the peak of the vaulted second-floor ceiling. A fan forces the hot air down a 30-foot duct next to the fireplace into a 3-foot-high crawl space. The warm air is stored there and returned to the lower sunspace.

To prevent heat loss through the sunspaces on winter nights and cloudy days, interior spaces can be closed off with glass doors. Insulating drapes protect north-facing windows.

In summer, Cowlishaw says overhangs and a fan are enough to prevent overheating in the sunspaces. But he plans to add heat-blocking screens to reduce some overheating through west windows.

The passive solar system isn't the only energy feature. The house is heavily insulated: R-36 2 × 6 exterior walls; R-44 ceilings; and R-4 and R-7 windows. In addition, three sides of the house are earth-sheltered.

The house is so tight that Cowlishaw said tests have measured the air change rate at between 0.4 and 0.2 changes per hour. Asked about any air quality problems at that low rate, he said an air-to-air heat exchanger is necessary at rates below 0.2, and "you should think about having one between 0.5 and 0.2."

In addition to a passive solar heating system, the house has a passive solar water-heating system which provides 70 percent of hot-water needs. Water contained in four tanks located in the clerestory is preheated by the sun and piped to hot-water heaters.

The solar hot-water system cost about $2,000, Cowlishaw said, and the other energy features totaled approximately $8,000.

Carol Anderson

ECONOMY

GYPSUM PRICES WILL KEEP ON RISING

Except for gypsum board, prices of building materials didn't go up much this year. Prices probably will increase a bit faster next year, but they shouldn't take off, predicted Barbara Alexander, who analyzes stocks of building companies and building materials producers for Salomon Brothers.

Speaking to NAHB's semiannual Residential Construction Forecast Conference in late October (see related story), Alexander said gypsum board prices "are likely to increase next year but not as much as this year," assuming that NAHB's forecast of 1.5 million housing starts in 1985 is correct.

According to the Producer Price Index, the price of gypsum products jumped nearly 20 percent between September 1983 and September 1984, the latest month for which statistics were available. Gypsum price increases (year-to-year) were much greater—as high as 30 percent—earlier in 1984.

By comparison, prices for all construction materials advanced only 2.5 percent from September to September. But even that small rise was greater than the 1.4 percent increase in the price of all commodities.

Although builders are paying much more for gypsum board—and at times this year they had a hard time getting it—lumber is a bargain.

Softwood lumber prices declined steadily from March to September 1984 and were 6 percent lower in September than a year earlier. Douglas fir prices fell even more (9.5 percent) from September to September, while the price of southern pine didn't change.

Why did gypsum jump and lumber fall? Competition had a lot to do with it, Alexander said. U.S. lumber producers face stiff competition from imports, especially Canadian, but gypsum doesn't.

"There is no good substitute product for gypsum board, and it's not an international commodity," Alexander said. In addition, clever marketing has expanded the market for gypsum, most recently into commercial construction, she added. As a result, producers could jump prices.

Lumber manufacturers aren't so lucky. In addition to imports made cheap by the strong American dollar, increased use of composite board and new production capacity, especially in the South, have held prices near their recession levels.

"Lumber prices will remain cyclical," Alexander said, "but it will be a long time before prices rise to the

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PRODUCER PRICE INDEX

Product	Percent change from Sept. 1983 to Sept. 1984
All commodities	1.4%
All construction materials	2.5
Prepared paint	4.9
Softwood lumber	−6.0
Douglas fir	−9.5
Southern pine	0
Other softwood	−6.6
General millwork	−0.5
Prefabricated structural members	2.0
Softwood plywood	0.7
Insulation board	2.3
Steel mill products	2.7
Mill shapes, nonferrous	0.8
Copper/brass mill shapes	−0.9
Hardware[1]	1.2
Builders' hardware	3.9
Plumbing fixtures/brass fittings	2.3
Vitreous china fixtures	5.1
Brass fittings	0.5
Heating equipment	4.4
Water heaters, domestic	−0.9
Fabricated structural steel buildings	2.4
Bright nails	0.3
Major appliances	2.4
Flat glass	−5.1
Portland cement	2.2
Concrete block and brick	4.1
Ready-mix concrete	2.8
Building brick	3.7
Clay tile	0.6
Prepared asphalt roofing	6.1
Gypsum products	19.6
Paving mixtures and block	7.1

[1]Not elsewhere classified

Source: Department of Labor, Bureau of Labor Statistics

NEWS

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peak level of the last housing cycle."

Here's what Alexander had to say about some other major building materials:

- Fiberglass insulation. Prices haven't gone up as much as expected (the Producer Price Index for insulation board advanced 2.3 percent from September 1983 to September 1984). Prices will remain "relatively accommodative to builders for the foreseeable future." Why? Increased production capacity and a slowdown in the retrofit market.
- Cement. Prices probably will go up some but will remain relatively low for at least the next few years because of more efficient plants and import competition, especially from Mexico.
- Roofing materials. It will be several more years before roofing prices go up much because greater production efficiency achieved by switching from organic felt shingles to fiberglass shingles has, in effect, increased capacity.

MARKETING

AD INDEX DELIVERS MESSAGE TO INDUSTRY

Builders spend a great deal on new home advertising, an estimated $750 million a year nationwide. Now a Hollywood, Fla.-based residential marketing firm has developed an index to measure new home display advertising volume in major newspapers throughout the country.

The New Home Advertising Index, initiated in April, was developed by the Greenman Group, Inc., as an indicator of industry strength in particular markets. The firm also collects comments from real estate advertising managers on current and predicted trends in the real estate market.

The amount of new home advertising is linked directly to builder confidence in home sales. Linage is high when builders expect sales to go well, but when times are tough, builders cut back. According to Ron Kukulski, real estate manager for the Fort Lauderdale *News/Sun Sentinel*, the index can provide a comparison of new home advertising linage nationwide. Being in one of the fastest growing real estate markets in the U.S., Kukulski would have reason to worry if his monthly or yearly linage declined while most of the nation's increased. Fred DeVoe, advertising director of the *Kansas City Star*, also watches the index but for a different reason. He examines the advertisements of East Coast newspapers, which mostly come from large builders. He feels large builders start trends which later will affect small builder advertisers in Kansas City.

Comments from real estate advertising managers included in the index also can provide valuable information. The comments explain regional activity and enable builders to spot trends which might influence their markets.

Andrew Greenman, president of the Greenman Group, says in the future he hopes to compare the number of ads with the number of homes sold.

Laura Lewis, assistant editor

ENERGY

TIGHTEST HOUSE IN TOWN ATTRACTS 115,000 PEOPLE

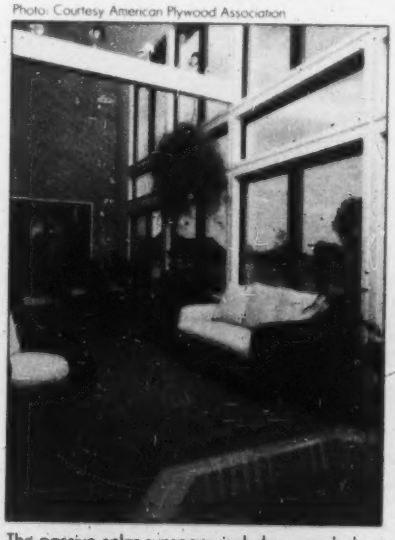
Ray and Bruce Baker are energy evangelists.

The father-son custom home building team, which specializes in solar and energy-efficient residences, has built what is arguably the tightest house in town for Cincinnati's 1984 Homearama, sponsored by the Home Builders Association of Greater Cincinnati.

Loaded with energy-saving features, the 3,178-square-foot house attracted 115,000 visitors during the June show. And though the $259,000 spec house hasn't sold yet, neither Baker is complaining. "Our number one concern [in Homearama] was to showcase various energy systems and to build our reputations as energy experts," says Bruce, vice president of Baker Homes. "We average seven starts a year and we have seven solid prospects from the show. All are interested in adapting at least some of the energy-conserving items we featured."

The Bakers' Homearama house has a two-story passive solar sunspace,

Photo: Courtesy American Plywood Association



The passive solar sunspace includes a sealed and insulated underfloor plenum and phase change solar heat panels; both store heat. A computer controls the hot tub's temperature.

phase change solar heat panels, superinsulation, quad-glazed windows, an all-wood foundation, radiant heat panels and foam caulking. Shutters, fans, blinds and temperature are all controlled by a $4,000 computer system, which also monitors lights and security alarms.

"Everyone wants energy efficiency, but no one wants to live like his great-grandfather did, opening and closing vents and blinds all day," says Ray Baker, president of the family firm. "And the computer also saves money, eliminating the need for regulating thermostats, dampers, even alarm clocks. Because of this, and because the computer lets you fine-tune the energy-conserving systems, I estimate the real cost of the computer at only $1,200 or $1,400."

Installing the energy and the computer systems wasn't difficult, insists Ray, an energy consultant for such companies as 3M and Dow Chemical. "Builders get confused and intimidated by silly books," he says. "But you just

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about San Francisco, Boston, Los Angeles and New York, where tight controls on development have kept supply in check.

In residential construction, investors are excited about multifamily housing. "Five years ago, lenders saw multifamily [development] as a poor investment," says Bolan. "But no one's laughing now." Still multifamily overbuilding plagues such Sunbelt cities as Houston, Phoenix and San Diego, while northeastern markets such as New York and Washington, D.C., remain strong.

The general public also has seen the need for multifamily housing. Homeowners are quietly subdividing large houses into smaller units or converting basements into granny flats. This rise in "middle-class meat-and-potatoes housing," as Bolan terms it, accounts for an estimated 400,000 to 500,000 new units a year. Yet because they don't have new foundations or footings, these units don't fit the Census Bureau's definition of starts. Bolan therefore dismisses all housing start statistics as "meaningless."

Other REPC predictions include:

- The return of housing primarily for use rather than investment. Home buyers won't move for at least four or five years after purchase, and the home improvement industry will boom.
- Death of the fixed-rate mortgage by the end of the decade.
- Preservation of mortgage interest rate deductions, although a limit to the amount an individual can deduct is conceivable.
- No relief on interest rates.
- Steady but moderate increases in home prices.
- A surge in the use of broker-based, computerized mortgage systems, creating a national mortgage market.
- Renewed interest in downtown housing and in maintenance-free, recreation-oriented projects for young professionals and single parents.
- Growing demand for life-care facilities for the affluent elderly.
- Emergence of Wall Street firms, including brokerage houses, investment bankers and financial services conglomerates, as full-service real estate companies. Financial "supermarkets" will offer developers "one-stop shopping"—from initial equity to construction financing to mortgage debt.
- Slowdown in the growth and size of regional shopping centers. But neighborhood shopping centers will increase in number and size. High-priced specialty shopping centers and low-priced warehouses selling generic goods also will proliferate.
- Rapid expansion of hotel chains. Overbuilding will encourage chains to invade new markets.

SURVEY

HOME PRICES FALL

First, the bad news: Over the past year, the average price of new and existing homes across the country has dropped.

A survey of 32 major metropolitan areas by the Federal Home Loan Bank Board (FHLBB) shows the average home price for the third quarter of 1984 was $94,000, down 0.3 percent from a year earlier. Prices declined in 13 cities and increased by more than 10 percent in only three cities: Boston, Minneapolis and New York.

Now the good news: Changes in the average sales price don't necessarily reflect economic trends. In fact, the greatest downturns and upswings in the FHLBB's third quarter survey are more a function of changing local market demands than general economic health.

Columbus, Ohio, for instance, felt the most precipitous drop in prices in the FHLBB's second quarter survey (−24.5 percent) and had the second greatest decrease in the third quarter (−14.5 percent). Although the combined decrease is the largest among the areas surveyed, Donald W. Kelly, president of the Columbus Board of Realtors, says "the market's never been stronger."

According to Kelly the change, from an average third quarter price of $80,200 in 1983 to $68,600 in 1984, is due to a shift in demand toward lower priced multifamily housing. "Comparing the first six months of 1983 and 1984, our statistics show an 80 percent increase in multifamily starts and only a 30 percent increase in single-family starts," says Kelly. He added that Columbus has a diversified economy that has been relatively unaffected by the past industrial recession. "There's also been a growth in research-type business, such as American Electric and Power and ATT, that has brought a lot of job transfers and, consequently, a demand for rental housing."

Similarly, Honolulu's home prices

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AVERAGE SALES PRICE OF NEW AND EXISTING HOMES
(in thousands)

SMSA	Third quarter 1983	Third quarter 1984	Percent change
Boston	$ 89.3	$104.4	16.9%
Minneapolis	92.8	107.5	15.8
New York City	118.3	131.4	11.1
Miami	74.9	81.9	9.3
Dallas-Fort Worth	103.9	113.5	9.2
Honolulu	135.8	114.3	−15.8
Columbus	80.2	68.6	−14.5
Greensboro	82.9	72.3	−12.8
Chicago	102.7	91.4	−11.0
Salt Lake City	98.1	88.4	− 9.9

Source: Federal Home Loan Bank Board; compiled by the NAHB Economics Division

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have dropped by 15.8 percent—the largest percentage in the nation—despite a healthy local economy. The main reason seems to be oversupply in a high-priced market (Honolulu had the highest home prices in the country during the second quarter). "We had a lot of speculative business in the late 1970s—people are unloading their properties," says Marcus Nishikawa, president of the Honolulu Board of Realtors. "We've also had a lot of foreclosures, which isn't normal in the state."

On the other hand commercial growth, pent-up demand and community resistance to new development have combined to push up prices in Boston, which experienced the largest price increase (16.9 percent) between the third quarters of 1983 and 1984. Average prices jumped from $89,300 to $104,400. "There's been no major subdivision in a year, which constricts supply and pushes up prices," says Wayne Stoddard, research director of the Greater Boston Real Estate Board. Demand has been strongest for upper-end single-family homes and condominiums, made more acute by the influx of professionals attracted by the surge of commercial development. As more people have moved to the area, community activists have sought to restrict new development, forcing some builders to specialize in renovation.

But in Minneapolis housing prices have risen for different reasons. Up 15.8 percent, from $92,800 to $107,500, between the third quarters of 1983 and 1984, prices have been sparked by soaring land costs and municipal charges, the need for high-cost energy-efficient construction and increased demand from the move-up market, according to William Gerst, assistant to the executive vice president of the Minneapolis Board of Realtors. "Activity is greatest in the lowest end and the highest," says Gerst. "The mid range is the only trouble spot. Construction is heavy in single-family; the multiple market has stabilized. And there are a lot of condo conversions coming through."

June Fletcher

GOVERNMENT

SOME HOMEOWNER TAX DEDUCTIONS MAY BE CUT

The Reagan administration is considering proposals to reduce or eliminate the mortgage interest tax deduction for second homes and the deduction for state and local property taxes.

The proposals are part of a plan being developed by the Treasury Department to simplify the tax system. Treasury's recommendations were scheduled to be sent to President Reagan by December 1, but it wasn't certain whether the recommendations would include the two housing-oriented deductions.

The second home deduction reportedly cost the government $1.2 billion in lost tax revenue last fiscal year.

Commenting on the second home proposal, Robert Bannister, NAHB's senior staff vice president for government affairs, said, "It looks like a trial balloon of sorts."

NAHB is studying the impact of the two proposals and others on the housing industry, Bannister said. Elimination of the second home deduction may not have a large impact on the national housing market, but he said it would have "a very adverse effect" on recreational and retirement markets.

"The impact would be greater in Florida, parts of New England and Tucson, for example, than in Dallas," he noted.

REGULATION

SUPREME COURT TO HEAR LANDMARK ZONING CASE

The U.S. Supreme Court is scheduled to decide the most important zoning issue currently facing the building business—whether property owners should be compensated financially when they are hurt by overly restrictive zoning and land-use regulations.

"It's the most important zoning case since 1926 when the Supreme Court decided that zoning is constitutional—assuming the Court decides the central issue," said Gus Bauman, NAHB's litigation counsel. The developer in the case, Hamilton Bank of Johnson City, Tenn., has asked Bauman to help write the bank's legal brief to the Supreme Court.

Hamilton sued the Williamson County (Tenn.) regional planning commission in 1981 after the commission retroactively applied new, lower density zoning regulations to a large subdivision near Nashville which was approved in 1973.

The developer had 258 acres left to develop of the 676-acre site when the commission decided to subject the remaining acreage to a zoning law passed in 1977. By then, the developer had spent up to $5 million on infrastructure for the entire building site and had dedicated 245 acres to the county, as required.

So the bank filed an inverse condemnation suit, charging that the commission had, in effect, "taken" the property by reducing its economic value, and seeking financial compensation.

A federal trial jury awarded the developer $350,000, and the commission was enjoined from applying the new zoning rules to the subdivision.

"The developer was able to prove that the property had been down-zoned so much that it was economically impossible to build the few houses allowed, that the effect was to stop further development," Bauman said.

The U.S. Court of Appeals affirmed the jury decision, agreeing that there had been a "taking" of property and that compensation was justified. Now the issue is before the Supreme Court, which is expected to hear oral arguments early next year and hand down a decision a few months later.

The Supreme Court has heard two similar zoning cases in the past few years, but both times it ducked the issue of compensation. However, Bauman believes that the current case has a better chance of deciding the issue.

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